South African Revenue Service

DRAFT INTERPRETATION NOTE 60 (Issue 2)

DATE:

ACT : INCOME TAX ACT 58 OF 1962
SECTION : SECTIONS 11(*o*), 20B AND 24M(1)
SUBJECT : LOSS ON DISPOSAL OF DEPRECIABLE ASSETS

CONTENTS

PAGE

Preamble

In this Note unless the context indicates otherwise –

- "**capital gains tax**" means the normal tax attributable to the inclusion of a taxable capital gain in taxable income under section 26A;
- **"depreciable asset"** means a depreciable asset as defined in **4.1.3**;
- **"paragraph"** means a paragraph of the Eighth Schedule;
- **"Schedule"** means a Schedule to the Act;
- **"section"** refers to a section of the Act;
- **"tax value"** means the amount remaining after reducing the cost or value of a depreciable asset by the cumulative capital allowances on that asset;
- **"the Act"** means the Income Tax Act 58 of 1962;
- **"year 1, 2, 3 … etc"** refers to a year of assessment; and
- any other word or expression bears the meaning ascribed to it in the Act.

All guides and interpretation notes referred to are available on the SARS website at **www.sars.gov.za**.

1. Purpose

This Note gives guidance on the interpretation and application of section 11(*o*), which grants a deduction for a loss on disposal of a qualifying depreciable asset as a result of alienation, loss or destruction.

2. Background

Section 11(*o*) provides for the deduction of an allowance on the alienation, loss or destruction of an asset used by a taxpayer in the carrying on of a trade. The allowance is subject to the following requirements –

- the taxpayer must make an election to claim the allowance as a revenue loss;
- the asset must be a qualifying asset, that is, it must have qualified for an allowance or deduction under specified sections of the Act;
- the expected useful life of the asset must not exceed 10 years as determined on the date of the original acquisition of the asset; and
- the cost of the asset must exceed the sum of any amount received or accrued from the alienation, loss or destruction of the asset and the amount of any allowance or deduction claimed or claimable against the asset.

The determination of the cost of the asset is subject to the provisos contained in section 11(*o*) and is discussed in **4.3.**

3. The law

Section 11(*o*)

11. General deductions allowed in determination of taxable income.— For the purpose of determining the taxable income derived by any person from carrying on any trade, there shall be allowed as deductions from the income of such person so derived**—**

(*o*) at the election of the taxpayer, an amount by which the cost to that taxpayer of any depreciable asset—

(i) which qualified for an allowance or deduction in terms of section 11(*e*), 11B, 11D, 12B, 12C, 12DA, 12E, 14, 14*bis* or 37B(2)(*a*); and

(ii) the expected useful life of which for tax purposes did not exceed ten years as determined on the date of original acquisition,

exceeds the sum of the amount received or accrued from the alienation, loss or destruction of that asset and the amount of any allowance or deduction allowed in respect of that asset in that year or any previous year of assessment or which was deemed to have been allowed in terms of section 12B(4B), 12C(4A), 12DA(4) or 37B(4) or taken into account in terms of section 11(*e*)(ix), as the case may be: Provided that for purposes of this paragraph-

(*aa*) the cost of any plant, machinery, implements, utensils or articles shall be deemed to be the actual cost plus the amount by which the value of such plant, machinery, implements, utensils or articles has been increased in terms of paragraph (v) of the proviso to paragraph (*e*); and

(*bb*) the actual cost of any plant, machinery, implement, utensil or article acquired by the taxpayer on or after 15 March 1984 shall be deemed to be the cost of that plant, machinery, implement, utensil or article as determined under paragraph (vii) of the proviso to paragraph (*e*).

Provided further that no election may be made in terms of this paragraph by the taxpayer if the amount received or accrued from the alienation, loss or destruction of the asset was received or accrued from a person that is a connected person in relation to the taxpayer;

4. Interpretation and application

4.1 Requirements

All of the requirements in **4.1.1** – **4.1.5** must be met in order for a person to qualify for a section 11(*o*) allowance.

4.1.1 Election of the taxpayer

Assuming all the requirements are met, a taxpayer must elect to claim the deduction under section 11(*o*). The section is silent on how the election must be made, but it is accepted that a taxpayer will have made an election under section 11(*o*) if the allowance is claimed in the return of income covering the period in which the disposal occurred.

In the event of the alienation, loss or destruction (see **4.1.5**) of a qualifying asset (**4.1.3**), section 11(*o*) potentially applies and the Eighth Schedule applies. Paragraph 11 defines the term “disposal” in wide terms. It includes, amongst others, the sale, donation, alienation, scrapping, loss or destruction of an asset. If a taxpayer is entitled to a deduction under section 11(*o*) but does not make the election to claim it, a capital loss will result under the Eighth Schedule.

A company may, for example, decide not to make an election under section 11(*o*) if that election would create or increase an assessed loss position and the company does not expect to trade during the succeeding year of assessment. Under section 20(1)(*a*) the company would forfeit any assessed loss created by the section 11(*o*) allowance because of the failure to trade,[1] while any capital loss that is not set off against other capital gains would not similarly be forfeited. See example in **4.6**.

No election may be made to claim a deduction under section 11(*o*) if the amount received or accrued from the alienation, loss or destruction of the asset was received or accrued from a connected person in relation to the taxpayer.[2]

4.1.2 The trade requirement

Cessation of trade

The deduction under section 11(*o*) forms part of the determination of a taxpayer's taxable income from carrying on any trade (opening words of section 11). The allowance will thus not be available to a taxpayer that has ceased to carry on trade.

Apportionment between business and private usage

The section 11(*o*) allowance must be apportioned under section 23(*g*) when an asset has been used for both business and private purposes.[3] The amount of the allowance is initially determined with reference to the original cost and total wear-and-tear allowances which would have been permitted ignoring any private element. Thereafter, the full amount of the allowance is apportioned in order to disallow the portion relating to private use and only claim the portion relating to business use.

Example 1 – Apportionment of section 11(*o*) allowance between business and private usage

Facts:

D, a sole trader, acquired a passenger vehicle at the beginning of year 1 at a cost of R500 000. The vehicle has an expected useful life for income tax purposes of five years. D claims a wear-and-tear allowance under section 11(*e*) on the straight-line basis. At the end of year 3 D sells the vehicle for R150 000. D's log book reflected the following odometer readings for the vehicle each year:

	Opening	Closing	Distance for year	Business	Private
Year 1	0	30 000	30 000	24 000	6 000
Year 2	30 000	55 000	25 000	15 000	10 000
Year 3	55 000	90 000	35 000	15 000	20 000
				54 000	36 000

[1] Interpretation Note 33 (Issue 4) dated 22 July 2014 "Assessed Losses: Companies: The 'Trade' and 'Income from Trade' Requirements".

[2] Second proviso to section 11(*o*). See also Interpretation Note 67 (Issue 2) dated 14 February 2014 "Connected Persons".

[3] ITC 322 (1935), 8 SATC 243 (U).

Result:

Year 3

Wear and tear allowance under section 11(e)

	R
Wear and tear (R500 000 / 5 years × 15 000 / 35 000)	42 857

Section 11(o) allowance

The section 11(*o*) allowance is initially determined with reference to the original cost and total wear-and-tear allowances ignoring any private element. Once the section 11(*o*) allowance has been established it is apportioned to disallow the portion relating to private use. The section 11(*o*) allowance is calculated as follows:

	R
Cost	500 000
Less: Section 11(*e*) allowances R500 000 / 5 × 3 (ignoring the portion disallowed for private use)	(300 000)
Tax value	200 000
Less: Consideration received	(150 000)
Section 11(*o*) allowance before adjustment for private use	50 000
Less: Private use 36 000 / 90 000 × R50 000	(20 000)
Section 11(*o*) allowance	30 000*

* This calculation is in the format which taxpayers commonly apply. It gives the same answer as the format used in the wording of section 11(*o*) which permits a deduction to the extent that cost R500 000 exceeds (the amount received or accrued R150 000 + allowances or deductions allowed or allowable R300 000), that is R50 000 which is then apportioned to exclude private use resulting in a section 11(o) allowance of R30 000.

Capital gains tax consequences

		R
Proceeds (paragraph 35)		150 000
Less: Base cost		(287 143)
Cost of acquiring asset [paragraph 20(1)(*a*)]	500 000	
Less: Amounts allowed as a deduction in determining taxable income [paragraph 20(3)(*a*)]:		
Allowed under section 11(*e*)	(182 857)**	
Allowed under section 11(*o*)	(30 000)	
Capital loss		(137 143)

In this example the vehicle was used mainly for the purposes of trade and it is therefore not a personal-use asset referred to in paragraph 53(2). If the vehicle had been a personal-use asset, the capital loss would have been disregarded under paragraph 53(1).

Notes:

** The following portions of the section 11(*e*) wear-and-tear allowances would have been allowed in each year of assessment:

		R
Year 1	R500 000 / 5 × 24 000 / 30 000	80 000
Year 2	R500 000 / 5 × 15 000 / 25 000	60 000
Year 3	R500 000 / 5 × 15 000 / 35 000	42 857
Total wear-and-tear allowed		182 857

In this example there is an overall economic loss of R350 000 comprising the cost of the vehicle of R500 000 less the proceeds of R150 000. This amount is accounted for as follows:

	R
Section 11(*e*) allowances allowed (see above)	182 857
Section 11(*o*) allowance allowed (see above)	30 000
Capital loss (see above)	137 143
Total amount claimed for income tax and CGT purposes	350 000

Assets previously used for private purposes that are introduced into the taxpayer's trade

A portion of the section 11(*o*) allowance must be disregarded when an asset that was previously used for private purposes is introduced into and used in the business. This adjustment can, for example, be made by determining the value of the asset at the time it is introduced into the business and applying that value in calculating future wear-and-tear allowances and, depending on the facts, recoupment or section 11(*o*) allowance.

Example 2 – Asset previously used for private purposes used in carrying on a trade

Facts:

E purchased a pick-up truck at the beginning of year 1 at a cost of R100 000 and used it for private purposes until the end of year 2 after which the pick-up truck was used exclusively in E's delivery business. The market value of the pick-up truck at that point was R60 000. The expected remaining useful life of the vehicle at the beginning of year 3 for tax purposes was three years. E sold the vehicle at the end of year 4 for R5 000.

Result:

For the purposes of section 11(*e*), the following wear-and-tear allowances were claimed:

Year 3 R60 000 / 3 = R20 000

Year 4 R60 000 / 3 = R20 000

The deduction under section 11(*o*) is determined as follows:

	R
Original cost of pick-up truck	100 000
Less: Loss in value due to private usage [section 23(*b*)]	(40 000)
Remaining cost for tax purposes	60 000
Less: Wear-and-tear allowances R60 000 / 3 × 2	(40 000)
Tax value	20 000
Less: Selling price	(5 000)
Section 11(*o*) allowance	15 000

4.1.3 Qualifying asset

The allowance applies to a "depreciable asset". The latter term is defined in section 1(1) as follows:

> **"depreciable asset"** means an asset as defined in paragraph 1 of the Eighth Schedule (other than any trading stock and any debt), in respect of which a deduction or allowance determined wholly or partly with reference to the cost or value of that asset is allowable in terms of this Act for purposes other than the determination of any capital gain or capital loss;

The term "asset" is defined in paragraph 1 as follows:

> **"asset"** includes —
>
> (*a*) property of whatever nature, whether movable or immovable, corporeal or incorporeal, excluding any currency, but including any coin made mainly from gold or platinum; and
>
> (*b*) a right or interest of whatever nature to or in such property;

The depreciable asset must have qualified for an allowance under one of the sections set out in the **Annexure** to this note. The section 11(*o*) allowance does not apply to a depreciable asset which qualified for an allowance or deduction under a section other than those listed in the **Annexure.** Section 11(*o*) will not, for example, apply to leasehold improvements to land or buildings which qualified for a deduction under section 11(*g*), intellectual property assets which qualified for a deduction under sections 11(*g*A), (*g*B) or (*g*C) and airport and port assets qualifying for a deduction under section 12F.

4.1.4 Expected useful life

In order to qualify for the section 11(*o*) allowance, the expected useful life of the asset for tax purposes must not exceed ten years as determined on the date of original acquisition. If the useful life of an asset is increased by way of an improvement, the section 11(*o*) allowance will still be applicable if the useful life of the asset did not exceed ten years as determined on the original acquisition date. The expression "for tax purposes" means that the expected useful life of the asset must be determined in accordance with the relevant deduction provision. For example, an aircraft qualifying for a 20% per year write-off under section 12C may in reality have an expected useful life of 20 years, but for tax purposes its expected useful life will be five years.

For assets qualifying for the wear-and-tear allowance under section 11(*e*), see Annexure A of Interpretation Note 47 (Issue 3)[4] for a schedule of write-off periods acceptable to SARS. The write-off period is equal to the expected useful life

[4] Dated 2 November 2012 "Wear-and-Tear or Depreciation Allowance".

for tax purposes. Assets included in Annexure A that will generally not qualify for a section 11(*o*) allowance, because their expected useful life for tax purposes as listed in the Annexure exceeds 10 years, include –

- certain air-conditioning assets such as air handling units (20 years), cooling towers (15 years) and condensing sets (15 years);
- artefacts (25 years);
- absorption type chillers (25 years) and centrifugal type chillers (20 years);
- escalators (20 years);
- fishing vessels (12 years);
- stand-by generators (15 years);
- lift installations (12 years);
- valuable paintings (25 years);
- pleasure craft (12 years);
- portable safes (25 years); and
- water distillation and purification plant (25 years).

A capital loss under the Eighth Schedule will have to be sought for these assets. If a taxpayer has obtained approval from SARS to write off any of these assets over a period not exceeding 10 years, the asset in question will be regarded as having an expected useful life equal to the approved write-off period and will potentially qualify for a section 11(*o*) allowance. An asset that is let for a period which exceeds that stipulated in Annexure A must be written off over the period of the lease. Therefore, for example, an asset that is let for a period of more than 10 years must be written off over the period of the lease as opposed to any shorter period which may appear in Annexure A, and will accordingly not qualify for a deduction under section 11(*o*).

The period of 10 years is determined on the date of original acquisition of the asset[5] and not the date on which it was brought into use.

4.1.5 "Alienation, loss or destruction"

The words "alienation, loss or destruction" are not defined in the Act and should be interpreted according to their ordinary meaning as applied to the subject matter in relation to which it is used.

Alienation

The word "alienation" is defined in the *Oxford English Dictionary*[6] as –

> "The transfer of the ownership of property rights."

The issue arises as to whether the scrapping of an asset comprises the alienation of an asset. The consigning of an asset to a scrap heap situated on the land of another person (for example, a municipal scrap heap) would comprise an alienation, since the taxpayer would be parting with ownership of the asset.

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5 Section 11(*o*)(*ii*).

6 **https://en.oxforddictionaries.com/definition/alienation** [Accessed 6 February 2017].

Similarly the donation of an asset also involves a transfer of ownership and would fall within the ambit of alienation. A taxpayer would have to ensure that it parts with ownership. For example, if a taxpayer donates computer software, the taxpayer would need to delete the software from its computer systems and physically dispose of the CDs or DVDs on which the software is stored.

The withdrawal of an asset from production (for example, for the purpose of mothballing the asset)[7] would not qualify as alienation because the taxpayer retains ownership of the asset. In order to qualify for the allowance the asset must be alienated from its owner.

Loss

The meaning of the word "loss" was considered by Watermeyer CJ in *Joffe & Co (Pty) Ltd v CIR*, in which he stated that –[8]

> "in relation to trading operations the word is sometimes used to signify a deprivation suffered by the loser, usually an involuntary deprivation, whereas expenditure usually means a voluntary payment of money".

The word "loss", in contrast to "expenditure", was described in the English case of *Allen (HM Inspector of Taxes) v Farquharson Brothers and Co* as follows:[9]

> "A loss is something different. That is not a thing which he expends or disburses. That is a thing which, so to speak, comes upon him ab extra."

The *Business Online Dictionary*[10] defines the term "loss" as follows:

> "Unrecoverable and usually unanticipated and non-recurring removal of, or decrease in, an asset or resource."

The term "loss" includes the theft of an asset.

Destruction

The *Oxford English Dictionary*[11] defines "destruction" as:

> "1. General: The action or process of causing so much damage to something that it no longer exists or cannot be repaired."

4.2 Limitation of losses under section 20B

Section 24M(1)

> **24M. Incurral and accrual of amounts in respect of assets acquired or disposed of for unquantified amount. —(1)** If a person during any year of assessment disposes of an asset for consideration which consists of or includes an amount which cannot be quantified in that year of assessment, so much of that consideration as—
>
> (*a*) cannot be quantified in that year must for purposes of this Act be deemed not to have accrued to that person in that year; and

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7 That is, putting the asset into storage for possible use in the future.

8 1946 AD 157, 13 SATC 354 at 360.

9 17 TC 59 at 64.

10 **www.businessdictionary.com/definition/loss.html** [Accessed 1 February 2017].

11 **https://en.oxforddictionaries.com/definition/destruction** [Accessed 1 February 2017].

> (*b*) becomes quantifiable during any subsequent year of assessment must for purposes of this Act be deemed to have been accrued to that person from that disposal in that subsequent year.

Section 20B

> **20B. Limitation of losses from disposal of certain assets.—(1)** Any deduction which is allowable during any year of assessment under section 11(*o*) in respect of the disposal by a person during that year of any asset the full consideration of which will not accrue to that person during that year, must be disregarded in that year.
>
> (2) So much of any amount disregarded in terms of subsection (1), which has not otherwise been allowed as a deduction, may be deducted from the income of that person in any subsequent year of assessment to the extent that any consideration which is received by or accrued to that person in that subsequent year from that disposal is included in the income of that person.
>
> (3) If during any year of assessment a person contemplated in subsection (1) proves that no further consideration will accrue to him or her in that year and any subsequent year as contemplated in subsection (2), so much of the amount which was disregarded in terms of subsection (1) as has not been allowed as a deduction in any year, must be allowed as a deduction from the income of that person in that year of assessment.

Section 24M(1) applies when an asset is disposed of for consideration which consists of or includes an amount which is unquantifiable. The unquantifiable amount of consideration is deemed to accrue when it becomes quantifiable in a subsequent year of assessment. Section 20B also potentially applies in this situation because one of its requirements is that the full amount of consideration in respect of a disposal has not accrued in a year of assessment.

In the absence of section 20B, section 11(*o*) could give rise to a larger allowance in the year of disposal than would be the case if the entire consideration[12] had been taken into account. Section 20B addresses this situation.

Section 20B(1) provides that a deduction under section 11(*o)* must be disregarded if the full consideration for the disposal of the asset has not accrued to the taxpayer during the year of assessment in which the disposal took place.

Under section 20B(2), the loss disregarded under section 20B(1) will be allowed in subsequent years of assessment to the extent that any consideration received or accrued from the disposal of the asset, which has not otherwise been allowed as a deduction, is included in the taxpayer's income in that subsequent year. This approach effectively means that in subsequent years of assessment the allowance disregarded under section 20B(1) must be reduced to the extent any consideration is received or accrues from that disposal provided that consideration has not otherwise been allowed as a deduction. The remaining portion of a disregarded allowance which has not been allowed as a deduction in any year of assessment will be allowed as a deduction in full in the year of assessment in which a taxpayer proves that no further consideration will accrue.[13]

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[12] That is, taking into account all amounts received or accrued in respect of the disposal in the year of assessment in which the disposal took place and in subsequent years of assessment.

[13] Section 20B(3). See also *Comprehensive Guide to Capital Gains Tax* (Issue 5) dated 9 December 2015 for a discussion of section 20B.

Depending on the amount which is ultimately received or accrued in respect of the disposal the taxpayer may need to account for a recoupment under section 8(4)(*a*).

Example 3 – Depreciable asset with a suspended section 11(*o*) allowance

Facts:

B acquired an asset at the beginning of year 1 for R57 000 (including value-added tax of R7 000) which was used in the production of B's income in carrying on a trade. B claimed the value-added tax of R7 000 as an input tax deduction under section 16(3) of the Value-Added Tax Act 89 of 1991. The asset had an expected useful life for income tax purposes of six years.

B used the asset for three years before selling it to C at the end of year 3 for 5% of the income generated by the asset over the next three years. B received R10 000 in year 4, R5 000 in year 5 and R6 000 in year 6.

Result:

Under section 23C(1) the cost of the asset for the purposes of section 11(*o*) excludes the value-added tax claimed as an input tax deduction.

Since the consideration owing to B consists of unquantified amounts at the end of year 3, section 24M(1) provides that the unquantifiable amounts are deemed to accrue once they become quantifiable. Accordingly, because consideration consists of amounts which will accrue in a subsequent year of assessment, under section 20B(1) the section 11(*o*) allowance of R25 000 is disregarded in the year of assessment in which the disposal of the asset took place.

Year 3

	R
Cost of asset	50 000
Less: Wear-and-tear allowances under section 11(*e*) R50 000 / 6 × 3	(25 000)
Tax value at time of sale	25 000
Less: Amount received or accrued	(Nil)
Section 11(*o*) allowance (disregarded)	25 000

Under section 20B(2) the disregarded allowance must be reduced by consideration which is subsequently received or accrued, provided it has not otherwise been allowed as a deduction, as follows:

	Year 4 R	Year 5 R	Year 6 R
Receipts	(10 000)	(5 000)	(6 000)
Disregarded section 11(*o*) allowance b/f	25 000	15 000	10 000
Disregarded section 11(*o*) allowance c/f	15 000	10 000	4 000

Notes:

As noted above, at the end of year 3 the section 11(*o*) allowance of R25 000 is disregarded, that is a deduction is not permitted. At the end of years 4 and 5 the remaining balance of the disregarded section 11(*o*) allowance of R15 000 and R10 000, respectively, may not be claimed under section 20B(3) because the full consideration for the disposal has not accrued to B at the end of each of those years of assessment.

B will be entitled to claim the remaining balance of the disregarded section 11(*o*) allowance of R4 000 at the end of year 6 under section 20B(3). At that stage no further amounts will accrue under the agreement of sale and the remaining balance has not otherwise been granted a deduction.

See the *Comprehensive Guide to Capital Gains Tax* (Issue 5)[14] for a discussion on the application of section 24M.

4.3 Calculation of the allowance

Under section 23C(1), any value-added tax payable on acquisition or delivery of an asset must be excluded from the cost for purposes of calculating an allowance if the taxpayer is a registered vendor that is entitled to a deduction of input tax under section 16(3) of the Value-Added Tax Act 89 of 1991.

The deduction under section 11(*o*) is equal to the amount by which the cost to the taxpayer of the asset exceeds the sum of –

- the amount received or accrued from the alienation, loss or destruction of the asset; and
- the amount of the allowances or deductions in respect of the asset allowed in the current or any previous year of assessment.

The second bullet point includes amounts deemed to have been allowed under sections 12B(4B), 12C(4A), 12DA(4) or 37B(4) or taken into account under section 11(*e*)(ix). These provisions deem a taxpayer to have claimed allowances during a previous year of assessment if the asset was used during that year in carrying on the taxpayer's trade, the receipts and accruals from which were not included in the taxpayer's income. This could apply, for example, if the taxpayer was previously not a resident and did not derive income from a source within South Africa.

Reformulated in more conventional terms, the section 11(*o*) allowance is equal to the amount by which the consideration received or accrued on disposal of the asset is less than its tax value. Tax value for this purpose means the actual cost of the asset (as opposed to the value of the asset) less the qualifying capital allowances.

As noted above, section 11(*o*) refers to the extent to which the cost of an asset exceeds, amongst others, the amount received or accrued from the alienation, loss or destruction of that asset. The section does not, however, require that any consideration must be received or accrued in order for a taxpayer to be able to qualify for a section 11(*o*) allowance. Accordingly, section 11(*o*) can apply if the

[14] In Chapter 10.

amount received or accrued is nil provided the requirements of the section are met. For example, it could apply to the theft of an uninsured asset.

4.3.1 Cost deemed to be actual cost subject to certain adjustments [paragraph (*aa*) of the first proviso to section 11(*o*)]

The cost of any plant, machinery, implements, utensils or articles is deemed to be the actual cost as determined under paragraph (*bb*) of the first proviso to section 11(*o*) (see **4.3.2**). The actual cost must be increased by the cost of moving such assets from one location to another [other than amounts allowed as a deduction under section 11(*a*)].

4.3.2 Cost determined under a cash transaction [paragraph (*bb*) of the first proviso to section 11(*o*)]

The actual cost of machinery, implements, utensils or articles acquired by the taxpayer on or after 15 March 1984 is deemed to be the cost which a person would, if that person had acquired such assets under a cash transaction concluded at arm's length on the date on which the transaction for the acquisition of such assets was in fact concluded, have incurred in respect of the direct cost of the acquisition of such assets, including the direct cost of the installation or erection thereof.[15] This provision ensures that interest and finance charges are excluded from the actual cost of an asset.

Therefore, depending on the facts of a particular case, the cost to acquire an asset includes the original purchase price of the asset (excluding input tax to which the purchaser is entitled), shipping or delivery charges and costs directly related to the installation and erection of the asset but excludes interest and finance charges.[16] In some cases, when determining actual cost, moving costs (see **4.3.1**) are added to the cost to acquire the asset.

4.3.3 Asset acquired from connected person – section 23J

Section 23J was repealed[17] in respect of depreciable assets acquired on or after 1 January 2013. A taxpayer may still have assets on hand which were acquired before 1 January 2013 and therefore fall under the ambit of section 23J.

Section 23J applies if a depreciable asset acquired by a taxpayer before 1 January 2013 was held by a connected person to that taxpayer during the period of two years prior to that acquisition.[18] For example, the taxpayer may have purchased the asset from a connected person or the seller, who is not a connected person in relation to the taxpayer, may have purchased the asset from a person who is a connected person in relation to the taxpayer within a period of two years before selling the asset to the taxpayer.

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15 Paragraph (bb) of the proviso to section 11(*o*) and paragraph (vii) of the proviso to section 11(*e*).

16 See paragraph 4.2 of Interpretation Note 47 (Issue 3) dated 2 November 2012 "Wear-and-tear or Depreciation Allowance".

17 Section 48 of the Taxation Laws Amendment Act 22 of 2012.

18 The connected person may exist at any time during that two year period [section 23J(1)].

Section 23J(1) limits the cost or value of the asset and the total amount of any deductions or allowances [for example, under section 11(*e*) and section 11(*o*)] which the taxpayer could potentially claim to the amount calculated under section 23J(2). The amount calculated under section 23J(2) is equal to –

- cost to the most recent connected person that held the depreciable asset as set out above for purposes of determining that connected person's related deductions;
- *less* all deductions allowed to the connected person for that depreciable asset[19] or deemed to have been allowed under sections 11(*e*)(ix), 12B(4B), 12C(4A), 12D(3A), 12DA(4), 12F(3A), 13(1A), 13*bis(*3A), 13*ter*(6A), 13*(quin)*(3) or 37B(4);
- *plus* other amounts required to be included in connected person's income as a result of the disposal of the depreciable asset by the connected person, for example, a recoupment under section 8(4(*a*);
- *plus* the applicable inclusion rate in paragraph 10 of the connected person's capital gain as a result of the disposal of the depreciable asset by the connected person.

The limitation in section 23J will apply if the amount calculated is less than the actual cost or value of the depreciable asset.

4.3.4 Assets acquired for no consideration

A taxpayer may acquire an asset for no consideration, for example by donation or inheritance. In practice, a wear-and-tear allowance will be granted on such an asset based on the value of the asset when it is introduced into the business. However, on disposal such an asset will not qualify for the section 11(*o*) allowance should the consideration be less than the tax value of the asset, since the asset does not have a cost.

4.3.5 Consideration in excess of tax value

If the consideration received or accrued on disposal of the asset exceed its tax value the excess will –

- be included in the taxpayer's income as a recoupment under section 8(4)(*a*), generally the recoupment will be equal to the extent that the consideration (limited to original cost), exceeds the tax value of the asset; and
- give rise to a capital gain, generally equal to the extent that the consideration exceeds the cost of the asset.

[19] For example, wear-and-tear allowances claimed under section 11(*e*) and an allowance claimed under section 11(*o*). An allowance would not have been permitted under section 11(*o*) if the seller and purchaser to a particular transaction were connected persons (see **4.1.1**).

4.3.6 Examples

Example 4 – Alienation, loss or destruction allowance

Facts:

The taxpayer purchased a machine at the beginning of year 1 at a cost of R10 000 and brought it into use on the same date. At the beginning of year 2, the taxpayer incurred an amount of R2 100 to move the machine to another location. The useful life of the machine for income tax purposes is five years and it is depreciated on a straight-line basis. The machine was sold for R3 000 at the end of year 3. The taxpayer claimed a wear-and-tear allowance during years 1, 2 and 3 under section 11(*e*).

Result:

	R
Cost of machine	10 000
Moving costs	2 100
Total cost	12 100
Less: Section 11(*e*) wear-and-tear allowance:	
*O*n machine (R10 000 × 20% × 3)	(6 000)
On moving costs (R2 100 × 25% × 2)	(1 050)
Tax value	5 050
Less: Selling price	(3 000)
Section 11(*o*) allowance	2 050

Note:

Under Interpretation Note 47 (Issue 3)[20] the moving costs are written off over the remaining useful life of the asset.

Example 5 – Loss of asset as a result of theft

Facts:

A taxpayer acquired a motor vehicle at a cost of R500 000 at the beginning of year 1. The vehicle had an expected useful life for tax purposes of five years. At the end of year 3 the vehicle was stolen and never recovered. The taxpayer received an insurance payout of R150 000 at the end of year 3.

Result:

	R
Original cost	500 000
Less: Wear-and-tear allowances R500 000 × 20% × 3	(300 000)
Tax value	200 000
Less: Insurance payout	(150 000)
Section 11(*o*) allowance	50 000

[20] Dated 2 November 2012 “Wear-and-Tear or Depreciation Allowance”.

Example 6 – Recoupments

Facts:

X purchased a motor vehicle at the beginning of year 1 at a cost of R30 000. X used the vehicle for business purposes for three years of assessment during which a wear-and-tear allowance of 20% per year was granted on the straight-line basis. X disposed of the vehicle for R25 000 at the end of year 3.

Result:

	R
Original cost of the vehicle	30 000
Less: Wear-and-tear allowance [section 11(*e*)]*	(18 000)
Tax value	12 000
Less: Selling price	(25 000)
Recoupment [section 8(4)(*a*)]	(13 000)

* Total allowances claimed after three years amounted to R30 000 × 20% × 3 = R18 000.

4.4 Asset disposed of by donation

A depreciable asset that is donated is alienated by the donor and consequently falls within the expression “alienation, loss or destruction”. In determining whether a deduction under section 11(*o*) is admissible for a depreciable asset that has been donated, sections 8(4)(*k*), 11(*o*) and 23(*g*) must be considered. The outcome will also have consequences for the determination of a capital gain or loss under the Eighth Schedule.

For the purposes of calculating whether there is a recoupment under section 8(4)(*a*), section 8(4)(*k*) deems, amongst others, an asset that has been donated, to have been disposed of for an amount equal to the market value of that asset on the date of donation. If the market value of the asset is less than or equal to its tax value, section 8(4)(*a*) will not apply and the section 11(*o*) allowance must be calculated without taking into account the deemed consideration under section 8(4)(*k*).

If the asset has been donated out of pure liberality without any expectation of a *quid pro quo,* the loss under section 11(*o*) will not have been incurred for the purposes of trade. The section 11(*o*) allowance will accordingly be disallowed under section 23(*g*). Depending on the facts of the case a deduction may be available under section 18A.

From a capital gains tax perspective, a taxpayer that donates an asset is deemed to have disposed of the asset for an amount received or accrued equal to its market value on the date of disposal under paragraph 38. The market value of the asset will be the proceeds on disposal of the asset under paragraph 35(1). If the depreciable asset was subject to a recoupment under section 8(4)(*a*) on disposal, the market value must be reduced by the amount of the recoupment under paragraph 35(3)(*a*). In determining the base cost of the asset, any expenditure referred to in paragraph 20(1)(*a*) to (*g*) must be reduced under paragraph 20(3)(*a*) to the extent that it has been allowed as a deduction in determining taxable income [for example, sections 11(*e*), 11(*o*) or 12C].

Example 7 – Donation of depreciable asset

Facts:

A taxpayer acquired a vehicle at the beginning of year 1 at a cost of R500 000 for the purposes of trade. The asset had an expected useful life under section 11(*e*) of five years. The taxpayer donated the vehicle to an approved public benefit organisation at the end of year 4 when the market value of the vehicle was R80 000. The donation fell under the 10% threshold referred to in section 18A(1).

Result:

	R
Cost of vehicle	500 000
Less: Wear-and-tear allowances [section 11(*e*)] R500 000 × 20% × 4	(400 000)
Tax value	100 000
Less: Amount received or accrued for the donation	(0)
Section 11(*o*) allowance	100 000

However, under section 23(*g*), the amount of R100 000 will not be allowed as a deduction under section 11(*o*), since it was not incurred for the purposes of trade.

Under section 18A(3)(*b*) the amount of the donation for the purposes of section 18A will be limited to the lower of R100 000 (cost less allowances allowed) and R80 000 (fair market value of the asset) assuming the other requirements of the section are met.

For the purposes of the Eighth Schedule, the proceeds on disposal of the asset will be R80 000 under paragraph 38. The expenditure on the asset under paragraph 20 will be reduced as follows under paragraph 20(3)(*a*):

	R
Cost of asset [paragraph 20(1)(*a*)]	500 000
Less: Amounts allowed against income [paragraph 20(3)(*a*)]:	
Wear-and-tear allowances	(400 000)
Section 18A deduction	(80 000)
Base cost	20 000
Proceeds (paragraph 38 read with paragraph 35)	80 000
Less: Base cost (as above)	(20 000)
Capital gain	60 000

4.5 Death of a taxpayer

Paragraph 40 is applicable to a person who dies before 1 March 2016. Under paragraph 40(1), for capital gains tax purposes, a person's assets are deemed to be disposed of at market value on date of death subject to some exceptions such as assets bequeathed to a surviving spouse. In determining the base cost of the asset in the hands of the deceased person, any expenditure referred to in paragraph 20(1)(*a*) to (*g*) must be reduced by any amount which is or was allowable as a deduction in determining taxable income,[21] for example, capital allowances under section 11(*e)* and section 11(*o*). The deemed market value proceeds do not extend to the determination of whether the taxpayer is subject to a recoupment under section 8(4)(*a*) or a deduction under section 11(*o*).

[21] Paragraph 20(3)(*a*).

Section 9HA(1) will be applicable to a person who dies on or after 1 March 2016. Similar to paragraph 40, the taxpayer's assets are deemed to have been disposed of at market value on the date of death, subject to the exceptions contained in section 9HA(1)(*a*) to (*c*). The deemed disposal at market value applies for purposes of the Act as a whole and therefore applies, for example, for purposes of capital gains tax and for purposes of determining whether there is a recoupment under section 8(4)(*a*) or a section 11(*o*) allowance.

The alienation of an asset as a result of the death of a taxpayer does not arise as a result of or for the purposes of carrying on trade. Accordingly, any section 11(*o*) allowance arising on death will be disallowed under section 23(*g*).

Example 8 – Death of taxpayer

Facts:

A taxpayer acquired a vehicle at the beginning of year 1 at a cost of R500 000 for the purposes of trade. The asset had an expected useful life for tax purposes of five years. At the end of year 4 (before 1 March 2016) the taxpayer passed away when the market value of the vehicle was R80 000.

Result:

	R
Cost of vehicle	500 000
Less: Wear-and-tear allowances [section 11(*e*)] R500 000 × 20% × 4	(400 000)
Tax value	100 000
Less: Amount deemed to have been received or accrued on death	(0)
Section 11(*o*) allowance	100 000

Under section 23(*g*) the amount of R100 000 will not be allowed as a deduction under section 11(*o*), since it was not incurred for the purposes of trade.

For the purposes of the Eighth Schedule, the proceeds on disposal of the asset will be R80 000 under paragraph 40. The expenditure on the asset under paragraph 20 will be reduced as follows under paragraph 20(3)(*a*):

	R
Cost of asset [paragraph 20(1)(*a*)]	500 000
Less: Amounts allowed against income [paragraph 20(3)(*a*)]:	
Wear-and-tear allowances	(400 000)
Base cost	100 000

	R
Proceeds (paragraph 40)	80 000
Less: Base cost (as above)	(100 000)
Capital loss	(20 000)

Note:

If the taxpayer had passed away on or after 1 March 2016, section 9HA(1) would be applicable and the taxpayer would have been deemed to have disposed of the asset for the purposes of the Act as a whole for an amount equal to the market value of the asset on the date of death. This would give rise to a section 11(*o*) allowance of R20 000 which would be denied under section 23(*g).* The capital loss on the deemed disposal of the asset would therefore still be R20 000.

4.6 Interaction between section 11(*o*) and the Eighth Schedule

For capital gains tax purposes, under paragraph 20(3)(*a*) expenditure included in base cost must be reduced by any amount which is or was allowable or is deemed to have been allowed as a deduction in determining taxable income and is not included in taxable income under section 9C(5). Therefore, a taxpayer that makes an election under section 11(*o*) must deduct the section 11(*o*) allowance from expenditure when determining base cost. This prevents the loss being duplicated with a claim under section 11(*o*) and as part of a capital loss. Similarly, any recoupment included in a taxpayer's income under section 8(4)(*a*) is excluded from the proceeds for capital gains tax purposes under paragraph 35(3)(*a*).

Example 9 – Interaction with Eighth Schedule – Taxpayer making an election under section 11(*o*)

Facts:

A taxpayer acquired an asset at a cost of R100 000 at the beginning of year 1. The asset has an expected useful life for the purposes of section 11(*e*) of five years. The taxpayer sold the asset at the beginning of year 3 for an amount received or accrued of R40 000 and made an election under section 11(*o*).

Result:

	R
Cost of asset	100 000
Less: Wear-and-tear allowances	(40 000)
Tax value	60 000
Less: Consideration received	(40 000)
Section 11(*o*) allowance	20 000

Determination of capital gain or loss

Base cost

Cost of asset [paragraph 20(1)(*a*)]		100 000
Less: Amounts allowed against income [paragraph 20(3)(*a*)]:		
Wear-and-tear allowances	(40 000)	
Section 11(*o*) allowance	(20 000)	(60 000)
Base cost		40 000

Capital gain or loss

Proceeds on disposal of asset	40 000
Less: Base cost (as above)	(40 000)
Capital gain or loss	Nil

Paragraph 20(3)(*a*) thus prevents a double deduction of the loss under the section 11(*o*) allowance and again as part of the capital loss.

Example 10 – Interaction with Eighth Schedule – Taxpayer not making an election under section 11(*o*)

Facts:

A taxpayer acquired an asset at a cost of R100 000 at the beginning of year 1. The asset has an expected useful life for the purposes of section 11(*e*) of five years. The taxpayer sold the asset at the beginning of year 3 for an amount received or accrued of R40 000 but elected not to claim a deduction under section 11(*o*).

Result:

Since no election has been made there is no deduction under section 11(*o*). A capital loss will accordingly arise.

	R
Proceeds	40 000
Less: Base cost [R100 000 acquisition cost – R40 000 Wear-and-tear allowance (R100 000 × 2 / 5)]	(60 000)
Capital loss	(20 000)

As a result of the section 11(*o*) allowance not being claimed, the taxpayer becomes entitled to a capital loss.

4.7 Limitation imposed on the lessor under section 23A

Section 23A(2) limits the sum of the deductions which may be claimed by a taxpayer under sections 11(*e*), 11(*o*), 12B, 12C, 12DA, 14*bis* and 37B(2)(*a*) to taxable income derived from rental income of "affected assets", as defined in section 23A. For more on section 23A, see Interpretation Note 53 dated 9 October 2015 "Limitation of Allowances Granted to Lessors of Affected Assets".

4.8 Prohibition of the allowance for certain assets falling under the First Schedule

A deduction under section 11(*o*) is prohibited by paragraph 12(2) of the First Schedule for machinery, implements, utensils or articles for which a deduction is allowable under paragraph 12(1) or (1A) of that Schedule.

5. Conclusion

A taxpayer may elect to claim a deduction under section 11(*o*) for the alienation, loss or destruction of a qualifying depreciable asset if the expected useful life of the asset does not exceed 10 years. An apportionment will be required to the extent the section 11(*o*) allowance was not incurred in the course of the taxpayer's trade.

If a taxpayer is entitled to but does not elect to claim a deduction under section 11(*o*), a capital loss will be determined under the Eighth Schedule.

The amount of the section 11(*o*) allowance is generally equal to the excess of the cost of the asset over the sum of any amount received or accrued from the alienation, loss or destruction of the asset and the amount of any allowance or deduction claimed or claimable against the asset. Otherwise stated, the section 11(*o*) allowance is equal to the amount by which the consideration received or accrued on disposal of the asset is less than its tax value. Tax value for this purpose means the actual cost of the asset (as opposed to the value of the asset) less the qualifying capital allowances.

Depending on the facts of the case, certain restrictions may apply to the determination of proceeds, cost or the amount of the section 11(*o*) allowance itself.

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SOUTH AFRICAN REVENUE SERVICE
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Annexure

Qualifying assets

Qualifying asset	Applicable section
Machinery, plant, implements, utensils and articles that qualified for the wear-and-tear allowance	11(*e*)
Buildings, machinery, plant, implements, utensils or articles, including improvements thereto, that were used for research and development that qualified for the allowance (applies to assets acquired before 2 November 2006). (Section 11B was repealed with effect from 12 December 2013)	11B
Buildings (or part thereof), machinery, plant, implements, utensils or articles, including improvements thereto, that were used for scientific or technological research and development that qualified for the allowance (applies on or after 2 November 2006). Section 12C(*g*A) applies to assets acquired for research and development purposes on or after 1 April 2012.	11D
Machinery, plant, implements, utensils and articles (other than livestock), including improvements thereto, that were used in farming or in production of renewable energy that qualified for the 50/30/20 allowance	12B
Machinery, plant, implements, utensils, articles, aircraft or ships, including improvements thereto, that qualified for a deduction	12C
Rolling stock that qualified for the allowance	12DA
The following assets of a small business corporation that qualified for the allowance: • Plant or machinery used in a process of manufacture or similar process • Machinery, plant, implements, utensils, articles, aircraft or ships	12E
Ships that qualified for the allowance (applies to ships acquired before 1 April 1995) (repealed with effect from 12 December 2013, and replaced by section 12C(*g*))	14
Aircraft that qualified for the allowance (applies to aircraft acquired before 1 April 1995) (repealed with effect from 12 December 2013, and replaced by section 12C(*f*))	14*bis*
New and unused environmental treatment and recycling asset that qualified for a deduction	37B(2)(*a*)